COVID-19 and Ontario mortgage enforcement practices

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Introduction

Given the current impact of COVID-19 on Ontario's economy, is it important to stay up-to-date on the province's mortgage enforcement practices.

This article deals with the following topics, which are essential considerations in any mortgage enforcement matter:

- The issuance of demand letters and notices;
- An overview of the various types of remedies available to a lender enforcing its security and some strategic considerations to keep in mind;
- A closer look into a popular enforcement remedy: the power of sale under mortgage process; and
- How a lender selling a property under power of sale can limit its exposure.

Demand letters and legislative notices

A. Demand letters

Generally, a lender, or its solicitors, should send a written demand letter to the borrower, and any guarantors, prior to commencing any enforcement against the borrower arising from a default.

The demand should include the nature of the default, the amount owing and a requirement to pay (or the ability to cure the default) within a certain time period. The terms of the loan and security instruments as well as other common law considerations should be reviewed for any other terms that should be included in the demand based on the particular fact situation, including with respect to the minimum payment or cure period.

It is also important to review the loan and security documentation to ensure that there is strict compliance with service and any other notice requirements. For example, sending the notice by fax or email may not be sufficient.

A demand letter is a relatively inexpensive initial step and may lead to favourable results while avoiding negative impacts or expensive proceedings. For example:

- The default in payment may have been an oversight by the borrower (*e.g.* new pre-authorized account, failure to provide post-dated cheques etc.);
- The demand letter might spur the borrower to rectify the default quickly;
- The curing of the default and/or a payment arrangement may assist to preserve the lender/borrower relationship; and
- If sufficient particulars of a non-monetary default are provided in the demand letter, the demand letter can guide the borrower on how to bring the mortgage into good standing.

B. Notices

The lender or its solicitor should consider other notices, which must be delivered prior to the enforcement of a loan, for example, pursuant to the *Bankruptcy and Insolvency Act* (BIA) and the *Farm Debt Mediation Act*. We note that certain notices are required to be delivered prior to the issuance of demands (*i.e.* Farm Debt Notice) while others can be combined with the demand letter (*i.e.* Section 244 Notice under the BIA).

BIA Notice

- The *BIA* requires a secured creditor to provide 10 clear days' prior written notice (in the prescribed form) of its intention to enforce its remedies against "*all or substantially all of the inventory, accounts receivable or other property*" of an insolvent debtor.
- This permits an insolvent debtor to file notice of its intention to make a proposal to its creditors and stay any proceedings.
- It may not be clear when a borrower falls under the definition of an insolvent debtor; therefore, it is common practice to issue a BIA notice as a matter of course to avoid the negative impacts of a failure to deliver such notice.

Farm Debt Mediation Act notice

- If the property is a "farm" or the borrower is a "farmer" under the *Farm Debt Mediation Act*, the lender is required to give the borrower 15 business days' prior written notice of its intent to enforce any remedy against the borrower's property or to realize on any security.
- The notice must also advise the farmer of the farmer's rights to apply for a review of the farmer's financial affairs, mediation with creditors and a stay of any proceedings.
- The farmer's right to apply for a review is contingent upon the farmer being currently engaged in farming for commercial purposes and being an insolvent person.

Overview of remedies

When a default is not satisfactorily resolved following the issuance of demands and notices, a lender will have to determine which remedies are available to it and consider which enforcement mechanism is more advantageous in the given situation.

Where market liquidity exists, and the market is non-depressed and realizable values are achievable, the power of sale proceeding is often chosen as the most time efficient and cost-effective method to achieve realization. However, each enforcement situation is unique and it is essential to choose the remedy or remedies that best suit the facts and circumstances of each situation.

Creating a strategy to determine the right type of remedy will depend on the facts of the situation, the legal and practical differences between available remedies, and factors such as the existence of collateral security and guarantees, prior encumbrances, outstanding municipal taxes, the solvency of the borrower, the physical condition of the property, environmental concerns and market trends and values.

A. Private power of sale

- A contractual remedy is available to the lender in where they act as the vendor of the property and sells it to a third party.
- There are strict requirements for the issuance of notices, to the owner of the property and others, prior to exercising this remedy.
- Under the right circumstances, this is a convenient, quick, and relatively inexpensive remedy.
- The redemption period is fixed with no provision for extension; however, there are strict limitations on what the mortgagee can and cannot due during this redemption period.
- The right to pursue the mortgagor for a deficiency after the sale is preserved. A mortgagee can also abandon the power of sale and commence an action for foreclosure without consent.
- The mortgagee bears the responsibility and risks of the transaction in its role as vendor of the property, and has the onus to account for the propriety of the conduct of the sale (including marketing of the property, appraisals, sale price and distribution of any surplus proceeds) and is therefore exposed to certain risks in choosing this remedy.
- Where the debtor does not cooperate, an action for possession of the property may be necessary.

B. Foreclosure

- In an action for foreclosure, the lender seeks to have the court order that the lender (or its assignee) will be the absolute owner of the mortgaged property, free of the interest of the borrower and all subsequent encumbrancers.
- If obtained, the ownership established by the court order will ultimately replace the borrower’s liability to repay the debt.
- This can be a useful process to settle complex issues such as priority accounts, just allowances, costs and prior encumbrances in one proceeding.
- Ultimately, a successful foreclosure remedy results in the lender (or its assignee) taking ownership of the property in exchange for extinguishment of the outstanding debt.
- As this is a court process, the mortgagee is generally shielded from any action by the mortgagor and does not have to account to the mortgagor for any profit on resale.

C. Judicial power of sale

- The lender can commence an action for sale where the court regulates all aspects of the sale and directs the payment of the proceeds of sale.
- The judicial scrutiny of the sale helps to insulate the lender from procedural and substantive liability, but comes at a higher cost in terms of time delays and other procedural expenses.

D. Action for arrears

- The lender can commence an action for payment of the arrears and seek judgment against the borrower, as well as others liable, such as guarantors.
- This may be a strategic option with good prospects for recovery without the need to resort to enforcement of the security. For example:
    - A situation where a closed mortgage interest rate is above market and the lender does not wish to provide the borrower with the opportunity to redeem; or
    - Where there are problematic issues related to the property or the security.
- A successful action for arrears will result in the recovery of all or a portion of the debt and will not directly involve enforcement against the property or other security instruments.

E. Action on the covenant (and guarantee)

- This is an action for payment on the contractual covenant contained in the mortgage when a default occurs under the mortgage.
- This action may be commenced concurrently in conjunction with a power of sale proceeding.
- An action on the covenant should be commenced in circumstances where it is clear that the value of the property is insufficient to satisfy the amount owing from the borrower rather than waiting for a deficiency to be realized.

F. Action for possession

- Where the lender cannot obtain possession of the mortgaged property (*e.g.* uncooperative borrower), the lender must commence an action for possession.
- The lender may also feel it is necessary to obtain vacant possession of the mortgaged lands because of the state of maintenance and repair of the property, insurance coverage issues, or building security considerations.
- A lender in possession is potentially exposed to environmental liability and other risks associated with having possession of the property.
- A successful action for possession allows the lender to deal with the property directly when there are concerns that the property is not being appropriately preserved and protected or cannot be delivered to a purchaser.

G. Notice to pay rents

- With income producing properties, the lender should consider serving notice to tenants to pay all future rents to the lender.
- Priority issues between the tenants (*e.g.* rent deposits) and the lender will become relevant and will need to be reviewed on a case-by-case basis.

- A successful and timely notice to pay rents will ensure that rents can be credited towards the indebtedness.

H. Receivership

- The lender may wish to hire an independent receiver or manager for the property. This can be achieved either by private or court appointment.
- Usually, this occurs when the property involves a going concern and the lender wishes to prevent the borrower from dealing directly with the property and other chattels subject to the lender's security.
- A privately appointed receiver is in a similar situation to that of a mortgagee-in-possession in that, once the receiver assumes management and control of the mortgaged property, the receiver may be exposed to risks associated with possession of the mortgaged property, for example, environmental risks. Significantly, the appointment of a private receiver generally does not shield the lender from these same risks and the lender is the ultimate vendor of the property and the instructing agent for the receiver.
- A court appointed receivership is entirely supervised by the court and the receiver acts as the officer of the court and has a general obligation to act in the best interest of all stakeholders. One of the primary benefits of a court-appointment receivership is that it will generally shield the lender from liability given that the court authorizes each step in the proceeding.
- There are several reasons that a creditor might choose a court appointed receiver including the fact that many purchasers of multi-residential and commercial properties are now requiring that title to assets be provided through a court-issued vesting order. A court appointment receivership is also preferable when there are competing priorities amongst creditors and/or a number of encumbrances against the property and the mortgagor's collateral.
- The lender should keep in mind that court appointed receivers are responsible to the court, whereas a privately appointed receiver has a principal duty of care to its appointing creditor.

Many considerations come into play when choosing an appropriate enforcement route. Similarly, the considerations above are not an exhaustive list of factors for developing a strategic enforcement strategy. BLG can assist you in developing a well-planned strategy that will be advantageous for your given situation and that will help mitigate against risks.

Mortgage enforcement: A closer look at the power of sale process

The contractual power of sale procedure is a common realization remedy chosen by lenders. A mortgagee may sell the property to a third party under the private power of sale provision contained in the mortgage in order to recover some, or all, of the debt in addition to its enforcement costs. The third party receives the property free and clear from the interests of the initial mortgagor.

Where the mortgage does not contain a contractual right of power of sale, the *Mortgages Act* does provide for a statutory power of sale under Part II thereof. Since the vast majority of mortgage agreements contain a contractual right to exercise a power of

sale on default we provide an overview of the main steps and considerations associated with enforcing a mortgage via the contractual right (as outlined in Part III of the Act), which permits expedited enforcement timelines.

A. Notices

Prior to enforcing a mortgage via the power of sale process, lenders should carefully review the loan and security instruments in order to confirm whether the lender has the contractual right to exercise this remedy upon default.

In addition, lenders must comply with all common law and statutory notice requirements, such as notices under the *BIA* or the *Farm Debt Mediation Act*, as applicable, in order to provide the debtor with an opportunity to remedy the default. Afterwards, the lender must also comply with the requirements applicable to the actual notice of sale under the *Mortgages Act*.

Mortgages Act Notice

- Notice of the exercise of power of sale may not be given until the default has continued for at least 15 days. If default has continued for at least 15 days, the notice of sale under mortgage should be sent to the mortgagee in the manner and form specified in the *Mortgages Act*.
- The mortgagee must give at least 35 days notice of its intention to exercise the power of sale to every person having an interest in the mortgaged property, including (as applicable):
    - The original mortgagor;
    - The owner, the spouse of the mortgagor, tenants;
    - Subsequent mortgagees, assignees of subsequent mortgagees;
    - Execution creditors, guarantors;
    - Construction lien claimants, statutory lien claimants;
    - Trustees in bankruptcy, court appointed receivers;
    - Dissolved corporations; and
    - Individuals or corporations with other interests where the mortgagee has actual or written notice of the interest.
- This 35-day window is known as the redemption period.

B. Redemption period and debtor rights

During the redemption period, mortgagors as well as other encumbrancers who received the notice of sale have the right to redeem the mortgage debt.

Under the *Mortgages Act*, a lender is precluded from taking any steps to enforce its mortgage during the redemption period, except under very limited circumstances. This means that lenders are precluded from taking steps such as:

- Commencing proceedings against the debtor;
- Taking possession of the property;
- Obtaining an appraisal for the property;
- Executing an agreement of purchase and sale; or
- Publishing notices regarding the sale of the property.

Compliance with the restrictions imposed on lenders under the *Mortgages Act* is very important given that non-compliance will result in potential liabilities and could invalidate all steps taken to date by the lender in the enforcement proceedings.

It is important to note that while lenders can start taking measures to sell the property following the expiry of the redemption period, mortgagors continue to have the right to redeem the mortgage up until the time of sale.

C. Taking possession of the property

If the mortgage has not been redeemed by the end of the notice period, the lender may take possession, either directly or through a receiver, and may assume control of the mortgaged property.

Lenders should consider negotiating an orderly change of possession. If the mortgagor is cooperative, the lender may obtain possession peacefully (*e.g.* changing the locks). Otherwise, the lender may be required to commence a court proceeding to obtain possession. If it is anticipated that the change of possession will not occur in an orderly manner, it will be important to determine when proceedings seeking an order for possession should be commenced (before, or after the Notices are delivered and following the redemption period). To the extent that the mortgagor does not defend the court proceedings, they will not overly complicate power of sale proceedings, but will add some additional delays.

Where court proceedings are required, the lender must obtain a Writ of Possession to be delivered to a sheriff who will issue an eviction notice to the mortgagor. If the occupants do not voluntarily leave the mortgaged property, the sheriff will attend and arrange for their removal.

It is important that mortgagees be aware that, in taking possession of the property and throughout the sale process, they must act in good faith and take reasonable care in obtaining the fair market value for the property.

D. Advantages and disadvantages

There are various advantages to exercising power of sale proceedings relative to other enforcement options. However, it is not always the most desirable or efficient way to proceed, in order to maximize realization and mitigate against potential losses and other risks.

Advantages	**Disadvantages**
• The amounts due under the mortgage are payable within 35 days following the issuance of the Notice vs. 60 days following the commencement of a judicial sale or foreclosure action; • The lender can manage the enforcement proceedings (and therefore the costs). Under the right circumstances, it can be a	• The lender is accountable for the transaction and is exposed to all risks, as it is the vendor of the property. This enforcement mechanism is therefore not ideal for properties of unknown or minimal value; • Where the debtor is uncooperative, court proceedings will be required to obtain

relatively quick and inexpensive remedy; • The lender may sue to recover any deficiencies following the sale of the mortgaged property; • The lender is not liable for land transfer tax when exercising a power of sale; and • The power of sale process may provide more flexibility than other enforcement methods as it may be abandoned without leave of the court.	possession of the property which inevitably cause additional delays; • Where the lender anticipates that the mortgaged property's value will increase over time, other enforcement options should be considered; and • Where profit is made on a sale, the lender has to account to the mortgagor for any surplus funds and is not entitled to these.

The sale of the mortgaged property and the agreement of purchase and sale

A mortgagee that decides to enforce its security by commencing power of sale proceedings assumes certain risks, obligations and duties in respect of the sale. However, various clauses can be included in an agreement of purchase and sale to provide additional protections to mortgagees selling real property under power of sale.

In any power of sale proceeding, the mortgagee should have its lawyer review the agreement of purchase and sale prior to executing it in order confirm that all necessary clauses have been included to ensure the mortgagee's obligations are limited.

A. Duties under power of sale proceedings

- There is an overarching duty imposed on the mortgagee to act in good faith and take reasonable care in obtaining the fair market value for the property.
- In order to adhere to these duties and withstand scrutiny by other stakeholders, it is recommended that the mortgagee obtain at least two appraisals for the property by a qualified appraiser in order to ascertain the fair market value prior to selling the property.
- While a mortgagee is not obligated to enter into a listing agreement with a real estate broker (as a mortgagee can proceed by way of private sale, tender or auction), consideration should be made to engaging a broker and/or working with other consultants as appropriate so as to ensure that the advertising and sales process is insulated from attack and to ensure that a larger market is reached to maximize the realization value of the property.
- Depending on the specific situation, other "pre-sale" steps may be desirable in order to minimize risks to the lender.

B. The agreement of purchase and sale

We recommend that you work with your solicitor to develop a form of agreement of purchase and sale to be used for any power of sale transactions. At a minimum, the agreement of purchase and sale should always be conditional upon review by the mortgagee's solicitors in order to provide an opportunity to ensure that the mortgagee's obligations are limited.

A few matters we recommend be addressed in the agreement of purchase and sale include:

- The purchaser should provide a specific acknowledgment that the property is being sold by power of sale under the mortgage;
- All standard form representations and warranties of the vendor should be reviewed and where appropriate removed;
- The purchaser should provide an acknowledgment that it is accepting the property on an entirely "as-is where-is" basis, including subject to all agreements, easements, encroachments, notices, leases, licences and all the encumbrances and land titles qualifications disclosed on the parcel register;
- Any real estate commissions should only be payable upon the successful completion of the sale (*i.e.* not until title is transferred to the purchaser);
- The vendor should have the ability to terminate the agreement at any time prior to the completion of the sale without liability (except for the return of the deposit), including as a result of the mortgage being redeemed prior to closing;
- The purchaser must agree to accept the property subject to all encumbrances which are not extinguished by the power of sale;
- If there are tax arrears or other utility arrears on the property, then the mortgagee should negotiate that the purchaser accept the arrears and adjust for that accordingly on the statement of adjustments;
- Clauses dealing with chattels will have to be removed unless the mortgagee is also selling personal property under the *Personal Property Security Act*; and
- The time period for acceptance by the mortgagee should be somewhat longer than the usual period for acceptance to ensure that the mortgagee is satisfied that it has or will have discharged its duties under the power of sale remedy.

This article is meant to serve as a general resource for mortgage enforcement. Accordingly, it is not meant to be an exhaustive review of the statutory and common law rules that apply to mortgage enforcement matters. We recommend that you seek legal advice in respect of any matter before enforcing a mortgage.

BLG's lawyers would be pleased to work with you to create a comprehensive strategy to deal with the nuances of your particular mortgage enforcement situation, to ensure any proceeding or action goes as smoothly as possible and that there are few surprises down the road. Please reach out to any of the key contacts below for assistance.

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